



City of Detroit

OFFICE OF THE AUDITOR GENERAL
Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 208
Detroit, Michigan 48226
Phone: (313) 224-3101
Fax: (313) 224-4091
www.ci.detroit.mi.us

Joseph L. Harris, CPA, CIA
Auditor General

Sharon L. Gipson, CPA
Deputy Auditor General

Press Release **City of Detroit Auditor General** **October 13, 2005**

The purpose of this message is to correct a few fallacies about the threat of the City's insolvency, the size of the City's budgetary gap, and the reengineering of the Police Department.

Our citizens need to know the truth. The City should not continue to mask its dire financial straits. The truth is that Detroit's treasury is hemorrhaging ... currently spending over \$15 million per month more than is being received. Insolvency is certain. The only question is the timing of the inevitable. It is my obligation to the citizens, for whom I work, to set the record straight.

The City's June 30, 2004 deficit was \$95 million. I believe the deficit increased by roughly \$50 million during the year ended June 30, 2005, for an accumulated deficit of about \$150 million.

Six months ago, the Mayor presented a proposed budget to City Council that included improbable revenues and unattainable cost reductions. The budgetary gap was estimated at \$309 million (Exhibit A).

The administration estimates the current year shortfall at \$186 million [See Exhibit B, which is erroneous, and the Mayor's "Budget Challenges (Exhibit C.)], which, if not corrected, would result in an accumulated deficit of about \$336 million at June 30, 2006 (\$150 million plus \$186 million).

The actuaries are estimating that pension and retiree health care costs will increase by an additional \$53 million next year (fiscal year ending June 30, 2007); and debt service is projected to increase by an additional \$27 million, for a total increase over the current year of \$80 million (Exhibit D).

The City's recent annual deficits are unlike any deficits the City has ever experienced. In the past, the City has been able to emerge from deficits by reducing its workforce and eliminating other non-essential costs until the next business cycle.

That option is no longer available. The City's annual deficits are being caused, primarily, by internal factors, most significantly pension and health care costs that the City is contractually obligated to pay, and which it cannot continue to pay at the current rate.

The City's current year budgetary gap is estimated at \$186 million (Exhibit C). Assuming that no other options are available, and that the average compensation of the individuals who are laid off is \$60,000, the City would be required to lay off 3,100 employees to close the budget gap for the current year (Exhibit D).



The Mayor's proposed budget included 16,765 employees, 4,631 who are not paid from General Fund revenues (Water and Sewerage (3,105), Library (465), Buildings and Safety Engineering (301), Municipal Parking (117), Airport (5), and grant funded (638).

The remaining 12,134 are comprised of uniformed Police (4,142) and Fire (1,300) employees; DPW, PLD, and Environmental Affairs employees (1,609); Department of Transportation employees (1,534); 36th District Court employees (365); City Clerk and Election Commission employees (107); and 3,077 employees in other capacities (Exhibit E).

The cost of pension and health care related expenditures (including pension obligation certificates) is estimated to rise by \$80 million the following year (FYE 2007). This would require layoffs of an additional 1,300 employees next year (Exhibit D). Following this line of reasoning, the City would be required to reduce its workforce by another 1,450 employees during the following three years, for a total of almost 6,000 layoffs in five years; leaving the City with a total of 6,000 General Fund employees.

The costs of pension and retiree health care benefits, as well as the related debt service, will continue to dramatically escalate annually until equilibrium is reached through layoffs and/or labor concessions. The amount of layoffs required to allow the City to maintain a balanced budget, while providing an acceptable level of City services, will be too great to compensate for the increasing cost of retiree benefits. Without considering the effect of decreasing revenues and other cost increases, Exhibit F depicts the anticipated budgetary gaps resulting from increasing costs related to pension and health care related costs.

This table shows that, all other things being equal (income tax revenues, property tax revenues, and state revenue sharing), and with no other significant cost relief, the City would need to reduce its General Fund workforce each year for the next several years, to break even. At some point, without employing other strategies, that tactic becomes untenable (Exhibit D).

Clearly, the City's pension and health care benefits costs are unmanageable. Moreover, as reflected Exhibit G, the payment schedules for the pension obligation certificates are back loaded, i.e., the annual payments increase each year until maturity. If the City cannot manage the debt load currently, it certainly will be unable to manage the debt load in future years.

Budgetary gaps have existed for the last three years. However, by borrowing long-term to cover short-term operating costs, we have mortgaged our future, while failing to address the structural issues that have caused the deficits. Even the current plans, or lack thereof, constitute the postponement of the tough decisions leaders are sometimes required to make.

Although the City's fate will have turned in a different direction long before these scenarios would be allowed to develop, they reveal the fact that the current trend is unsustainable. The City's financing agreements for pension obligations, along with health care costs for retirees will continue to rise for the foreseeable future.



On the revenue side, total income taxes, property taxes, utility users taxes, and state revenue sharing are all expected to decline (Exhibit H) during the foreseeable future as the City's population continues to decline (Exhibit I) and the state's structural deficit prompts further state revenue sharing reductions. Casino revenues are not anticipated to increase dramatically in the near future.

In summary, there are no stopgap measures that can be implemented to close the budgetary gap. Decreasing revenues combined with increasing expenditures, including unmanageable employee and retiree benefits can only lead to the City's eventual insolvency.

The Mayor proposes to reduce the budgetary gap by obtaining \$42 million in concessions from the civilian labor unions, by selling \$33 million of City owned land, by reducing payments to the Risk Management Fund (self-insurance fund) by \$12.5 million, by obtaining State senate approval for changes in the utility users tax, by transferring the Cobo Civic Center to a regional authority, and various other implausible measures. These major pieces to his plan only scratch the surface. The only way out of this conundrum is a major reengineering of the entire City government including, particularly, the terms of the City's labor contracts.

The scenarios shown above will result if there is no relief from the State legislature (Act 312 Arbitration) and the labor union contracts. The civilian General Fund employees cannot, reasonably, absorb the excess costs. \$180 million shared by 6,692 civilian employees amounts to concessions of \$27,000 per employees. Public Safety employees must participate in the concessions, which are impeded by Act 312 Arbitration requirements (Exhibit J).

Exhibit K is intended to show that the actual deficit has been significantly higher than the reported deficit, i.e. the difference between the City's revenues and expenditures. By borrowing over \$200 million over the past two years, the reported deficit is expected to approximate \$300 million, despite expenditures exceeding revenues by over \$500 million.

If Public Safety, DDOT, DPW, and PLD, 36th District Court, City Clerk and Elections are spared, and no other relief is effected, the City would be required to eliminate over twenty departments (Exhibit E).

Without current cash balances and cash flow projections, I am unable to predict the timing of the City's insolvency. However, it is clear that insolvency is inevitable. The City cannot sustain the current cost of City government; and no measures are in place or are being planned to forestall such an eventuality.

Recent announcements regarding the reengineering of the Police Department demonstrate the reality that our City officials do not understand the meaning of reengineering, which is defined as a fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance, such as cost, quality, service, and speed.



Restructuring is not reengineering. Closing police precincts and consolidating resources does not effect a transformation of processes, which must be radically redesigned if significant efficiencies are to be realized. Moreover, it would take years to reengineering the City's police department. To think that the City's police department can be reengineered in three or four months demonstrates the Department's lack of understanding of the concept.

Moreover, if the City is to recover financially, reengineering of major processes is an absolute necessity. The City continues to use outmoded processes that have existed for over fifty years ... and no plans are in place to replace them.

This message is intended to be a call to arms, not an attempt to throw daggers at City officials, because the blame transcends the current administration. The question is, where do we go from here?

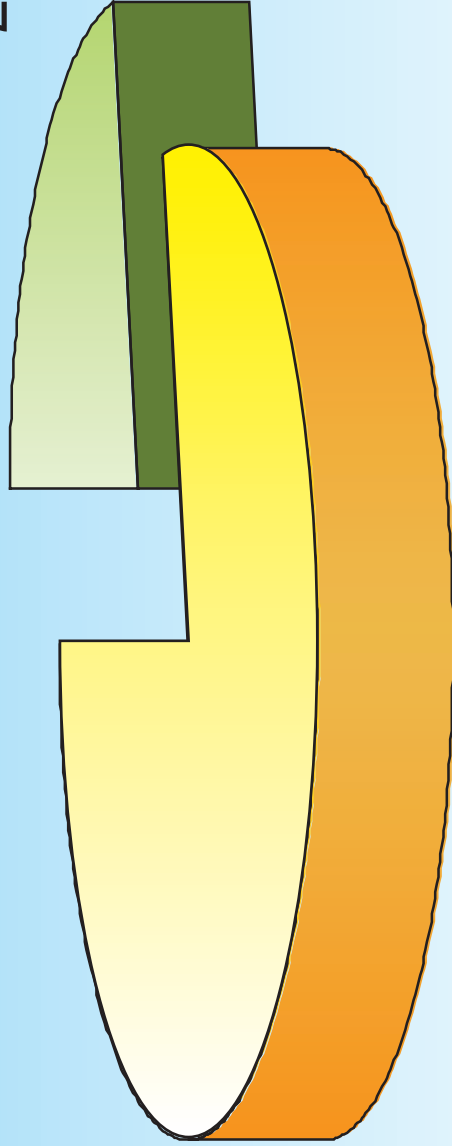
The City's decreasing revenues and increasing costs cannot be blamed on the current administration. Although more could have been done, nothing could have staved off the overwhelming weight of the labor contracts to which the City is committed.

Without major concessions by the City's labor unions and legislative relief by the State, the City's fate is sealed. We cannot afford to wait until the hurricane has arrived to prepare for the inevitable. We need to strengthen the levees and put our recovery plans in place immediately.

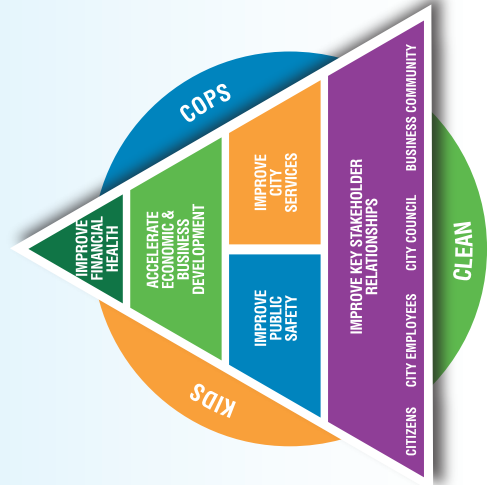
Comparison of Beginning Fiscal Year Budget Gap and General Fund Budget

\$309 Million
22%

\$1.4 Billion



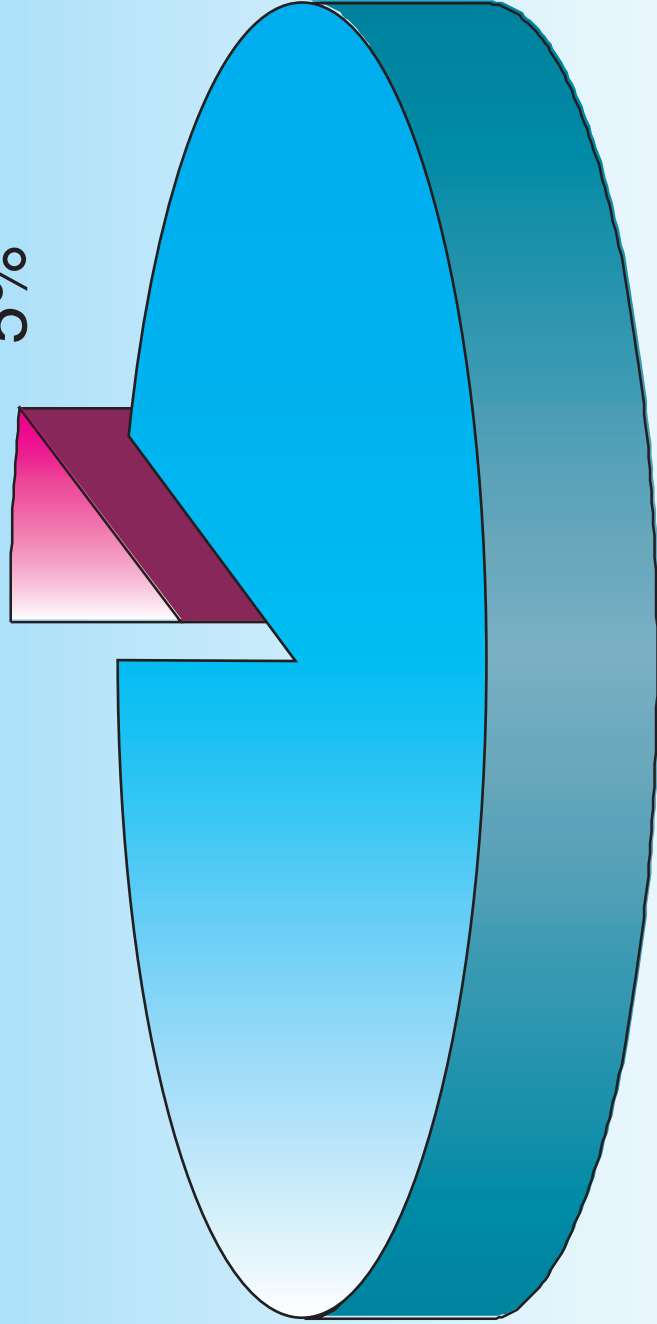
■ Beginning Fiscal Year Budget Gap
■ General Fund Budget



Comparison of General Fund Budget and Current Budget Gap

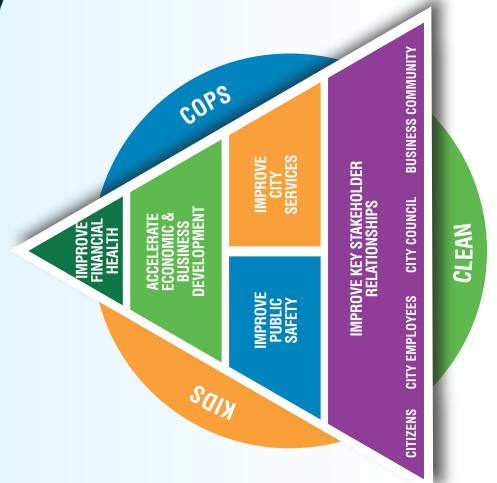
\$78.8 Million

5%



\$1.4 Billion

Current Gap
General Fund Budget



FY 2005-06
Budget Challenges

	Projected through 09/30/05	
DOWOP - Union	8.60	July 1- September 30 lost savings assume 1 month implementation
DOWOP Layoffs	<u>(8.33)</u>	effective 7/19 209 layoffs
	0.27	Shortfall after layoffs
Healthcare (UNLIKELY)	17.50	July 1- September 30 lost savings plus 2 months for open enrollment period
Zoo	4.00	Society currently unable to provide support
Uniform Cuts		
Police	53.77	Council's Cut
Fire	15.12	Council's Cut
Implemented Plan		
Police	(15.46)	150 Layoffs effective Sept 15
Fire	<u>(5.88)</u>	65 FF layoffs 10 Bat Chiefs eliminations effective Sept 23
	47.55	Shortfall after cut plan implemented
Sept 27 Budget Amendment	{ Submitted to City Council (47.55) (not approved) }	
Pension Payments	15.00	Budget is less than actual payments due in 2005-06
Healthcare (UNLIKELY)	24.50	Shortfall from 10/01-6/30/2006; \$3.5 Million monthly
DOWOP (UNLIKELY)	17.20	Shortfall from 10/01-6/30/2006; \$2.15 Million monthly
Projected Gap	<u>\$ 78.47</u>	As of September 30, 2005
Utility User Tax (QUESTIONABLE)	6.30	Need Senate approval
GDDRA (QUESTIONABLE)	5.00	2 year deficit reduction plan
Cobo (HIGHLY UNLIKELY)	2.00	Regional Authority needs to be completed by March 2006
Personal Exemption (??)	2.00	Change in Ordinance needed by October 2005
Property Sales (HIGHLY UNLIKELY)	33.00	Watch for progress over the year
Risk Management Fund (IRRESPONSIBLE)	12.50	Monitor over the year
Items to be Monitored	<u>\$ 60.80</u>	
Total	<u>\$ 139.27</u>	
	47.55 ←	
Current Budgetary Gap	<u><u>186.82</u></u>	

Layoff Scenario

			Actuarially	Annual	Total			
			Estimated	Pension	Retiree			
	Current		Pension and	Obligation	Costs and			
	Budgetary		Health Care	Certificates	POC			
FYE	Gap *		Costs *	Payments *	Payments *	Increases *	Required	Layoffs **
2006	\$ 186	\$	333	\$ 72	\$ 405		3,100	
2007		\$	386	\$ 99	\$ 485	\$ 80	1,300	
2008		\$	408	\$ 104	\$ 512	\$ 27	450	
2009		\$	431	\$ 110	\$ 541	\$ 29	500	
2010		\$	454	\$ 116	\$ 570	\$ 29	500	
Total							5,850	
*		amounts in millions						
**		assuming an average total compensation of \$60,000						

Employee Count by Department

<u>Agency</u>	<u>Employees</u>	
Total City Employees		16,765
Enterprise Fund Employees		
Water and Sewerage	3,105	
Library	465	
Buildings and Safety Engineering	301	
Municipal Parking	117	
Airport	5	
Total Enterprise Fund Employees	3,993	
Grant Funded Employees	638	
Total Enterprise and Grant Funded Employees		4,631
 Total General Fund Employees		 12,134
Core Services Employees		
Police*	4,142	
Fire*	1,300	
DPW, Public Lighting, Environmental	1,609	
Transportation	1,534	
36th District Court	365	
City Clerk and Elections	107	
Total Core Service Employees		9,057
 Remaining General Fund Employees		 3,077
Budget	24	
Civic Center	83	
Communication	17	
Finance	343	
Fire (civilian)	441	
Health	324	
Historical	15	
Human Resources	322	
Human Rights	8	
Information Technology	153	
Law	146	
Mayor's Office	96	
Economic Development	48	
Police (civilian)	399	
Recreation	264	
Zoo	153	
Administrative Hearings	6	
Homeland Security	52	
Auditor General	21	
Zoning	13	
City Council	105	
Ombudsman	6	
Other	38	
Total Remaining General Fund Employees		3,077
		-

* Does not reflect recent layoffs

Do Nothing Scenario

		Actuarially	Annual	Total		Excess
		Estimated	Pension	Retiree		Expenditures
	Current	Pension and	Obligation	Costs and		over Expenditures
	Budgetary	Health Care	Certificates	POC	Annual	Assuming no
FYE	Gap *	Costs *	Payments *	Payments *	Increases *	Layoffs
2006	\$ 186	\$ 333	\$ 72	\$ 405		\$ 186
2007	\$ 186	\$ 386	\$ 99	\$ 485	\$ 80	\$ 266
2008	\$ 186	\$ 408	\$ 104	\$ 512	\$ 27	\$ 293
2009	\$ 186	\$ 431	\$ 110	\$ 541	\$ 29	\$ 322
2010	\$ 186	\$ 454	\$ 116	\$ 570	\$ 29	\$ 351
Total						\$ 1,418
*	amounts in millions					

POC Bond Debt Service

	(Amounts in Millions)			
FYE	PFRS	GRS	Total	
2006	\$ 33	\$ 40	\$ 73	
2007	56	43	99	
2008	59	45	104	
2009	62	48	110	
2010	65	50	115	
2011	69	53	122	
2012	73	55	128	
2013	77	58	135	
2014	81	61	142	
2015	86	64	150	
2016	90	67	157	
Totals	\$ 751	\$ 584	\$ 1,335	

Major Revenue Trends

	(Amounts in Millions)					
	<u>2002 Actual</u>	<u>2003 Actual</u>	<u>2004 Actual</u>	<u>2005 Actual</u>	<u>2006 Budget</u>	
Income Tax	\$ 324	\$ 311	\$ 290	\$ 285	\$ 275	
Property Tax	170	166	185	165	186	
Utility Users Tax	52	55	50	52	50	
State Revenue Sharing	332	320	286	284	285	
Casino Revenue*	122	189	168	153	168	
	\$ 1,000	\$ 1,041	\$ 979	\$ 939	\$ 964	
Bonds Issued to						
finance operations	-	-	131	141	-	
Total funds available						
from major sources	\$ 1,000	\$ 1,041	\$ 1,110	\$ 1,080	\$ 964	
* Casino Revenue includes Wagering Tax, Municipal Service Fees, and Casino Enhancement Fees						
Annual Deficits	\$ (2)	\$ 71	\$ 26	\$ 55	\$ 150	
Cumulative Deficits (surplus)	\$ (2)	\$ 69	\$ 95	\$ 150	\$ 300	

Population Trends

Year	Population	Residents		Percent	
		Lost		Lost	
1950	1,849,568				
1960	1,670,144	179,424		10%	
1970	1,514,063	156,081		9%	
1980	1,203,368	310,695		21%	
1990	1,027,974	175,394		15%	
2000	951,270	76,704		7%	
2005 *	890,158	61,112		6% (for five years)	
	* SEMCOG's Population Estimate at 9/1/05				

Pension & Medical Benefit Costs

	(Amounts in Millions)				
			Health		Annual
Year	Pension	Care	Totals	Increases	
2006	\$ 181	\$ 152	\$ 333		
2007	216	170	386	\$ 53	
2008	219	189	408		22
2009	223	208	431		23
2010	228	226	454		23
2011	231	245	476		22
2012	236	262	498		22
2013	241	277	518		20
2014	246	291	537		19
2015	251	303	554		17
	\$ 2,272	\$ 2,323	\$ 4,595	\$ 221	

Deficits & Financing

	(Amounts in Millions)				
	Surplus/ (Deficit)	Amount	Cumulative Deficit		
Fiscal Year	Cumulative	Financed **	Spending	Description	
2001-2002	\$2				
2002-2003	(\$69)				
		\$0	\$ (71)		
2003-2004	(\$95)				
		70		Long-term financing to pay annual insurance premium	
		61	(157)	To finance previous year deficit	
2004-2005	(\$150) *				
		80		Long-term financing to pay annual pension contribution	
		61	(196)	Long-term financing to pay annual insurance premium	
2005-2006	\$ (300) *	\$0	(150)		
		<u>\$272</u>	<u>(574)</u>		
*	estimates				
**	exclusive of refunding				